

**SURREBUTTAL TESTIMONY OF**

**DAVID C. PARCELL**

**ON BEHALF OF**

**THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF**

**DOCKET NO. 2018-82-S**

**IN RE: APPLICATION OF PALMETTO WASTEWATER RECLAMATION, LLC**

**FOR ADJUSTMENT OF RATES AND CHARGES**

**Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND OCCUPATION.**

**A.** My name is David C. Parcell. I am a Principal and Senior Economist of Technical Associates, Inc. My business address is Suite 130, 1503 Santa Rosa Rd., Richmond, Virginia 23229.

**Q. DID YOU FILE DIRECT TESTIMONY AND EXHIBITS IN THIS PROCEEDING?**

**A.** Yes. I filed Direct Testimony and two (2) exhibits with the Public Service Commission of South Carolina ("Commission") on March 12, 2019.

**Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

**A.** The purpose of this Surrebuttal Testimony is to respond to the Rebuttal Testimonies of Palmetto Wastewater Reclamation, LLC ("PWR") witnesses Harold Walker, III and Mark S. Daday. Mr. Walker's Rebuttal Testimony is generally focused on the following topics: ownership of PWR, capital structure issues, proxy group, risk factors, Discounted Cash Flow ("DCF") issues, Capital Asset Pricing Model ("CAPM") issues, Comparable Earnings ("CE") issues, and overall cost of equity ("ROE") issues. Mr. Daday's Rebuttal

1 Testimony is generally focused on what he claims is an incorrect value of the Company's  
2 cost of debt.

3 My Surrebuttal Testimony accordingly is organized to respond to the rebuttal  
4 testimonies regarding each of these topics.

5 **Q. DOES ANYTHING CITED IN MR. WALKER'S OR MR. DADAY'S REBUTTAL**  
6 **TESTIMONIES CAUSE YOU TO CHANGE YOUR COST OF EQUITY**  
7 **RECOMMENDATION IN THIS PROCEEDING?**

8 **A.** No.

9 **I. OWNERSHIP STRUCTURE OF PWR**

10 **Q. MR. WALKER STATES, ON PAGES 3-4 OF HIS REBUTTAL TESTIMONY,**  
11 **THAT YOU ARE MAINTAINING THAT PWR HAS LOWER RISKS DUE TO ITS**  
12 **OWNERSHIP BY NI PACOLET MILLIKEN UTILITIES AND THAT YOU ARE**  
13 **RECOMMENDING "SOMETHING LESS THAN A FAIR RATE OF RETURN"**  
14 **DUE TO THIS OWNERSHIP. IS HE CORRECT IN HIS ASSERTIONS?**

15 **A.** No, he is not correct. What I do demonstrate in my Direct Testimony (pages 16-  
16 17) is that PWR is owned by Ni Pacolet Milliken Utilities, LLC ("Ni"), as are other utilities  
17 in South Carolina and other states. PWR's debt capital is apparently arranged by Ni and,  
18 in fact, a significant portion of PWR's debt is in the form of intercompany loans within the  
19 Ni "family."

20 Mr. Walker is apparently proposing that this relationship be ignored and PWR be  
21 considered as a "stand-alone" entity that raises all its capital on its own behalf. This is  
22 simply not the reality of the Company's situation. Further, my Direct Testimony does not

1 make any downward adjustment to “something less than a fair rate of return” due to the  
2 ownership of PWR by Ni.

3 **Q. DOES YOUR 9.6 PERCENT COST OF EQUITY FOR PWR REFLECT**  
4 **“SOMETHING LESS THAN A FAIR RATE OF RETURN”?**

5 **A.** No, it does not. As I indicate elsewhere in my Surrebuttal Testimony, my 9.6  
6 percent cost of equity for PWR is consistent with other ROE awards for water/wastewater  
7 utilities throughout the U.S. in recent years.

8 **II. CAPITAL STRUCTURE ISSUES**

9 **Q. WHAT ARE THE RESPECTIVE CAPITAL STRUCTURE ISSUES IN THIS**  
10 **PROCEEDING?**

11 **A.** PWR, through the Direct and Rebuttal Testimonies of Mr. Walker, is proposing a  
12 capital structure comprised of 40.3 percent debt and 59.7 percent common equity. PWR  
13 refers to this as its “actual” capital structure.

14 In my Direct Testimony, I propose a hypothetical capital structure with 45 percent  
15 debt and 55 percent common equity. This reflects the approximate capital structure ratios  
16 of the proxy groups used to develop the ROE in both mine and Mr. Walker’s testimonies.

17 **Q IN HIS REBUTTAL TESTIMONY (PAGE 5, LINES 1-2), MR. WALKER STATES**  
18 **HIS VIEW THAT YOU “HAVE NOT PRESENTED ANY EVIDENCE PROVING**  
19 **PWR’S ACTUAL CAPITAL STRUCTURE IS UNREASONABLE.” DO YOU**  
20 **AGREE WITH MR. WALKER’S CLAIM?**

21 **A.** No, I do not. As I indicated in my Direct Testimony (pages 16-19 and Schedule 3  
22 of Exhibit DCP-2), PWR’s actual capital structures have been very volatile over the past  
23 five years:

Year	Equity Ratio
2014	29.7%
2015	60.9%
2016	57.8%
2017	46.7%
2018	60.9%

1 This demonstrates that, whereas PWR's equity ratio may have been 59.7 percent in  
2 the Test Year (*i.e.*, 12-months ended August 31, 2018), this is not necessarily representative  
3 of the Company's capital structure over time. Mr. Walker neither acknowledges nor  
4 disputes this volatility in his Rebuttal Testimony.

5 In addition, as is also indicated in my Direct Testimony (page 17, lines 1-4), a  
6 substantial portion of PWR's capital is in the form of "advances from affiliates." This is  
7 somewhat unusual among utilities and illustrates that PWR's capital structure is not  
8 "market driven" as are the capital structures of the proxy companies (as cited in my Direct  
9 Testimony on page 18, lines 10-13). Mr. Walker also neither acknowledges nor disputes  
10 this capital source in his Rebuttal Testimony.

11 Finally, as I indicate in my Direct Testimony (page 17 and Schedule 4 of Exhibit  
12 DCP-2), the recent (2014-2018) and prospective (2021-2023) capital structure ratios of his  
13 proxy group are:

Capital Structure Ratio Measure	Average	Median
Historic	54.5%	55.6%
Prospective	55.4%	54.4%

14 Each of these factors, which were included in my Direct Testimony, reflect  
15 evidence that PWR's actual and proposed capital structures are unreasonable.  
16 Accordingly, I disagree with Mr. Walker's claim that I have not presented evidence that  
17 the Company's proposed capital structure is unreasonable.

**III. PROXY GROUP ISSUES**

**Q. WHAT ARE THE ALTERNATIVE PROXY GROUPS PROPOSED IN THIS PROCEEDING?**

**A.** I examined three groups of proxy water utilities in my Direct Testimony (pages 19-20 and Schedule 5 of Exhibit DCP-2). One of these is the proxy group selected by Mr. Walker in his Direct Testimony.

In my Direct Testimony (page 20, lines 1-3) I note that two of Mr. Walker's proxy water companies are currently involved in major acquisitions and do not appear to meet one of his selection criteria (not announced subject of acquisition). In his Rebuttal Testimony (page 6, lines 5-9), Mr. Walker maintains that it is acceptable for a proxy company to be acquiring another utility, but not to be acquired by another utility. Either of these events can have an impact on a utility's stock price and thus its ROE model results (*i.e.*, DCF and CAPM). As a result, it does not matter if the potential proxy company is acquiring or being acquired; either way, it is impacted by the merger.

Despite this apparent disagreement between Mr. Walker and myself, the impact is moot. My ROE analyses consider his proxy group as well and, in fact, my ROE results are more reflective of his proxy group than the proxy group I identified.

**Q. MR. WALKER MAINTAINS, ON PAGE 7, LINES 3-12 OF HIS REBUTTAL TESTIMONY, THAT YOU DID NOT "PRESENT ANY EVIDENCE REGARDING THE SIMILARITY, OR DISSIMILARITY, OF RISK BETWEEN HIS COMPARISON COMPANIES AND PWR." WHAT IS YOUR RESPONSE TO THIS ASSERTION?**

1     **A.**           As I indicated previously, I used both my proxy group and Mr. Walker's proxy  
2                   group in my ROE analyses and noted that my ROE conclusions gave more weight to his  
3                   proxy group.

4                   I also note, as I did in my Direct Testimony (page 20, lines 6-7), that Mr. Walker  
5                   regards his proxy group as having similar risk to PWR. As a result, to the same extent that  
6                   Mr. Walker regarded his proxy companies to have similar risk to PWR, and to the extent  
7                   that his ROE recommendations for PWR are directly determined from the ROE results  
8                   applied to his proxy group, my analyses correspondingly regard the proxy group to have  
9                   similar risk to PWR. Stated differently, my analyses follow the same track as those of Mr.  
10                  Walker.

#### 11                                   **IV.     RISK FACTOR ISSUES**

12     **Q.     WHAT ARE THE RISK FACTOR ISSUES CITED BY MR. WALKER?**

13     **A.**           Mr. Walker cites the following "risk" factors in his Rebuttal Testimony as being  
14                   differences in our respective analyses: PWR's debt expense tied to the London Inter-bank  
15                   Offered Rate ("LIBOR"), increases in prime lending rate, tax reform, relative size of PWR,  
16                   and expected increases in interest rates.

17     **Q.     WHAT IS MR. WALKER'S POINT REGARDING PWR'S DEBT INTEREST**  
18                   **EXPENSE BEING TIED TO THE LIBOR RATE?**

19     **A.**           Mr. Walker claims (page 7, lines 19-22) that PWR's interest is tied to a 1-month  
20                   LIBOR rate. Because of this, he maintains PWR bears the burden of higher interest rates  
21                   as short-term rates increase.

22                   I have two responses to this claim by Mr. Walker. First, he notes (page 7, lines 19-  
23                   20) that this is a risk that makes PWR different from my proxy group. As I have noted

1 previously, my ROE analyses and risk assessments apply to Mr. Walker's proxy group as  
2 well as those of my own proxy group. Thus, I have performed similar evaluations to those  
3 Mr. Walker did in his Direct Testimony, where this purported risk factor was not identified.

4 Second, Mr. Walker has only identified one aspect of how utility rates are tied to  
5 interest costs tied to the LIBOR. Not cited by Mr. Walker is the fact that, when the LIBOR  
6 goes down, the rates charged by utilities are not automatically reduced to reflect this. In  
7 this instance, the opposite event cited by Mr. Walker occurs: PWR's customers' rates are  
8 not automatically reduced to reflect this occurrence.

9 **Q. MR. WALKER NEXT CITES THE INCREASES IN THE PRIME LENDING RATE**  
10 **SINCE 2014. WHAT IS YOUR RESPONSE TO THIS?**

11 **A.** This is essentially the same claim made regarding changes in the LIBOR discussed  
12 previously. As a result, my same responses apply to this claim.

13 In addition, as I described in my Direct Testimony (pages 13-14), short-term  
14 interest rates fell to a near-zero level after the 2008 Great Recession as the Federal Reserve  
15 sought to help the U.S. economy recover from this severe economic malaise. Interest rates  
16 cannot be expected to remain at such a low rate forever. Nor do investors expect them to  
17 remain near zero forever. There has always been an expectation that they would eventually  
18 return to a more normal level. Such expectations are reflected in stock prices and thus in  
19 ROE models such as DCF and CAPM. Thus, this is neither a new nor a significant factor  
20 in evaluating the risk of PWR.

21 I also note that, on March 20, 2019 the Federal Reserve indicated that it is not  
22 planning any rate hikes in 2019. In addition, the Federal Reserve announced that it plans  
23 to slow the "roll-off" of its balance sheet (*i.e.*, disposal of a portion of its holdings of U.S.

Treasury securities purchased as part of the Quantitative Easing cited in my Direct Testimony) and conclude its current reduction in Treasury securities as of the end of September 2019. These actions further indicate that Mr. Walker's predictions of interest rate increases are problematic.

**Q. MR. WALKER NEXT CITES TAX REFORM (PAGE 8) AS A RISK FACTOR FOR PWR. WHAT IS YOUR RESPONSE TO THIS ASSERTION?**

**A.** I note, first, that Mr. Walker's reference to tax reform is couched in the context of rating agency (*i.e.*, Moody's and Standard & Poor's) references to the rating metrics these agencies use to establish security ratings. As I indicated in my Direct Testimony (page 16, lines 13-14), PWR's debt is not rated and the Company's debt is in the form of Bank of America Term loans and intercompany loans. This latter form of loans, in particular, does not rely on the metrics cited by the rating agencies.

**Q. MR. WALKER CITES THE RELATIVE SIZE OF PWR AS A RISK FACTOR (PAGES 9-10). WHAT IS YOUR RESPONSE TO THIS?**

**A.** I discussed, at length, the impact of size on risk for utilities in my Direct Testimony (pages 43-45 and Schedules 12 and 13 of Exhibit DCP-2). Mr. Walker neither acknowledged nor refuted this in his Rebuttal Testimony.

**Q. MR. WALKER CITES (PAGES 10-12) AN EXPECTATION THAT INTEREST RATES WILL INCREASE IN THE FUTURE AS A RISK FACTOR. DO YOU AGREE WITH THIS?**

**A.** No, I do not. As I indicated previously, there may have been an expectation for several years that interest rates would increase. As I discussed in my Direct Testimony (pages 12-13), there has been "anticipation" of increases in rates for some time, but this



anticipation has largely been unrealized. Also, as I indicated in my Direct Testimony (page 13, lines 7-8 and Schedule 2 of Exhibit DCP-2), long-term rates have actually declined in recent months. Clearly, the future movement of interest rates is an unknown. This is further true due to the Federal Reserve's decisions on March 20<sup>th</sup> as cited above.

**Q. FINALLY, MR. WALKER MAINTAINS (PAGES 10-11) THAT YOUR REFERENCE TO LOWER EXPECTED INVESTMENT RETURNS WAS NOT CORRECT. DO YOU HAVE ANY RESPONSE TO HIS CLAIM?**

**A.** Yes, I do. Long-term total returns (*i.e.*, 1926-2017<sup>1</sup>) in the equity markets have been:

Stock Index	Geometric	Arithmetic
Large Cap Stocks <sup>2</sup>	10.2%	12.1%

The most recent returns for the S&P 500 (for the period ended December 31, 2018), have been:<sup>3</sup>

One Year	-4.38%
3 Years	9.26%
5 Years	8.49%

This demonstrates that returns since the Great Recession have been lower than the longer-term periods. It is thus clear that the expectations I cited in my Direct Testimony have turned out to be accurate and Mr. Walker's claims are incorrect.

#### **V. DISCOUNTED CASH FLOW MODEL ("DCF") ISSUES**

**Q. WHAT ARE THE DCF ISSUES RAISED IN MR. WALKER'S REBUTTAL TESTIMONY?**

<sup>1</sup> 2018 SBBI Yearbook, Stocks, Bonds, Bills and Inflation, Duff and Phelps. Note that this source is cited by Mr. Walker in footnote 25 on p. 21.

<sup>2</sup> S&P 500.

<sup>3</sup> T. Rowe Price Report, Insights on Investing and Financial Topics, Winter, 2019.

1     **A.**             Mr. Walker cites the following perceived issues in my DCF analyses: use of  
2             retention growth rates, use of analysts' earnings per share ("EPS") forecasts, and the  
3             differences in book values and market values and related impact of the DCF results.

4     **Q.     WHAT ARE YOUR RESPONSES TO THE FIRST TWO ISSUES CITED BY MR.**  
5     **WALKER?**

6     **A.**             Mr. Walker claims that I should not have considered retention growth rates (pages  
7             12-13) and that I should have given primary consideration to analysts' forecasts of EPS  
8             growth (pages 13-14) in my DCF analyses. Mr. Walker's claims are made without  
9             considering how my DCF conclusions were derived.

10            As is clearly shown on Schedule 6 of Exhibit DCP-2 of my Direct Testimony, the  
11            highest DCF results that I derived, and the results that I focus on in my 9.2 percent DCF  
12            conclusions, are the First Call EPS forecasts. Thus, Mr. Walker's criticisms are moot and  
13            neither recognize nor dispute the fact that I give primary weight to the EPS forecasts.

14     **Q.     WHAT IS THE NATURE OF MR. WALKER'S CLAIM THAT THERE IS A**  
15     **DIFFERENCE BETWEEN THE MARKET VALUES AND BOOK VALUES OF**  
16     **THE PROXY GROUPS?**

17     **A.**             Mr. Walker is claiming that the market value of the proxy groups exceeds the book  
18             values and, thus, the use of market-based models such as DCF do not provide a proper  
19             estimate of the cost of equity for utilities (pages 15-18).

20     **Q.     DO YOU AGREE WITH THIS PROPOSITION?**

21     **A.**             No, I do not. As I have noted elsewhere in my Direct Testimony and Surrebuttal  
22             Testimony, investors are well aware that utilities have their rates established based upon  
23             the book values of their rate base and capital structure, as well as expenses and revenues.

As a result, the stock prices of utilities reflect the recognition of book value for utilities. Consequently, there is no logical basis for “adjusting” the stock prices (and thus, DCF results) of utilities to reflect any perceived divergence between book value and market value.

**VI. CAPITAL ASSET PRICING MODEL (“CAPM”) ISSUES**

**Q. WHAT ARE THE CAPM ISSUES CITED BY MR. WALKER?**

**A.** Mr. Walker claims the following issues with my CAPM analyses: use of both market returns and accounting returns, use of both capital gains and income returns in the market returns, use of both arithmetic and geometric returns, and size premiums.

**Q. WHAT ARE MR. WALKER’S CLAIMS REGARDING THE USE OF BOTH MARKET RETURNS AND ACCOUNTING RETURNS IN DEVELOPING THE RISK PREMIUM COMPONENT OF THE CAPM?**

**A.** Mr. Walker maintains (pages 18-19) that it is not proper to use accounting returns (*i.e.*, earned ROEs and interest rates) in developing the risk premium component.

**Q. WHAT IS YOUR RESPONSE TO THIS ASSERTION?**

**A.** I disagree with Mr. Walker. As I indicate on pages 28-29 of my Direct Testimony, I used measures of both book returns (*i.e.*, accounting returns) and market returns in developing my CAPM risk premium components. The rates (*i.e.*, prices) of public utilities are established based upon the book values of their rate base and capital structures, as well as the book levels of expenses and revenues. As such, it is appropriate to consider the level of return on book equity in the determination of the cost of equity (which is applied to the book level of common equity in the capital structure). I also note that the risk premium I

1           derive from my use of book rates of return is the highest of the three risk premium measures  
2           I considered in my CAPM analyses.

3   **Q.   WHAT IS MR. WALKER’S CLAIM ABOUT THE USE OF BOTH CAPITAL**  
4   **GAINS AND INCOME RETURNS IN DEVELOPING THE MARKET RISK**  
5   **PREMIUM?**

6   **A.**           Mr. Walker claims (page 20, lines 1-7) that, in using the SBBI studies to determine  
7           long-term (*i.e.*, 1928-2017) risk premiums, one should use total returns for common stocks  
8           (*i.e.*, dividends and capital gains) and only income returns on long-term government bonds.

9   **Q.   DO YOU AGREE WITH MR. WALKER ON THIS POINT?**

10   **A.**           No, I do not. Mr. Walker is proposing that we should compare, in developing a risk  
11           premium, total returns on common stocks with only income returns on bonds. This  
12           excludes the capital gain component on bonds (which is the lower return of the two  
13           components) and makes the resulting risk premium appear higher. Such an approach is  
14           inconsistent and does not reflect an “apples to apples” comparison.

15   **Q.   WHAT IS THE NATURE OF MR. WALKER’S CLAIM THAT ONLY**  
16   **ARITHMETIC RETURNS SHOULD BE USED IN DEVELOPING LONG-TERM**  
17   **AVERAGE RETURNS AND RISK PREMIUMS?**

18   **A.**           Mr. Walker states (pages 20-21) that only arithmetic returns should be used to  
19           measure long-term average growth rates and thus risk premiums.

20   **Q.   DO YOU AGREE WITH MR. WALKER?**

21   **A.**           No, I do not. It is apparent that investors have access to both arithmetic and  
22           geometric returns in the materials provided to them by investment advisory services and  
23           mutual funds. For example, Value Line (one of the sources of EPS growth cited by Mr.

Walker in his DCF analysis on Schedule 13 of his Direct Testimony) reports growth rates on a compound (*i.e.*, geometric) basis, not on an arithmetic basis. In addition, mutual funds, following Securities and Exchange Commission requirements, report returns on a geometric basis. Based upon this, I find it difficult to accept Mr. Walker's position that only arithmetic returns are considered by investors and are the only appropriate measure of returns. Finally, as I noted previously, I considered both arithmetic and geometric returns in my analyses.

**Q. MR. WALKER ALSO CITES A "SIZE ADJUSTMENT" TO THE CAPM RESULTS. WHAT IS YOUR RESPONSE TO THIS?**

**A.** I previously discussed the lack of need for a size adjustment for a utility. As a result, I do not discuss this further here.

## **VII. COMPARABLE EARNINGS ("CE") ISSUES**

**Q. WHAT CE ISSUES DOES MR. WALKER CITE IN HIS REBUTTAL TESTIMONY?**

**A.** Mr. Walker's claims (pages 22-24) first cite the appropriateness of my use of the ROEs of the S&P 500 Index in my CE analyses. In addition, he claims that the proxy groups' ROEs are higher than my CE conclusions.

**Q. WHAT IS YOUR RESPONSE TO THE FIRST CLAIM OF MR. WALKER?**

**A.** I note that my reference to the S&P 500 group is provided as a check and is not used as a direct measure of the ROE for PWR. I also note in my Direct Testimony that the S&P 500 is more risky than water/wastewater utilities (page 35, lines 12-19 and Schedule 11 of Exhibit DCP-2 of my Direct Testimony).

**Q. PLEASE RESPOND TO MR. WALKER'S SECOND CLAIM.**

A. Mr. Walker's Rebuttal Testimony cites only selective portions of my CE analyses for the proxy water groups. As I indicate in my Direct Testimony (pages 34-35 and Schedules 9 and 11 of Exhibit DCP-2), over the past two business cycles the proxy groups have had average ROEs of 9.1 percent to 9.9 percent. Meanwhile, investors priced the stocks of these groups at twice the book value of the stock, indicating an acceptance of these returns. Prospective ROEs are higher, but the most recent market-to-book ratios are over 300 percent (*i.e.*, stock price is a multiple of three times book value), which indicates these higher returns exceed the cost of capital.

### VIII. RECOMMENDED COST OF EQUITY ISSUES

**Q. WHAT DOES MR. WALKER CLAIM CONCERNING YOUR COST OF EQUITY RECOMMENDATION IN THIS PROCEEDING?**

A. Mr. Walker claims, on page 24 of his Rebuttal Testimony, that my 9.6 percent ROE recommendation for PWR is inadequate.

**Q. DOES MR. WALKER PROVIDE ANY JUSTIFICATION FOR THIS CLAIM?**

A. Mr. Walker's only justification is a single ROE decision in South Carolina for a water utility. He does not cite any other water utility decisions in his Rebuttal Testimony.

**Q. WHAT HAVE BEEN THE AVERAGE AUTHORIZED RETURNS ON EQUITY FOR WATER UTILITIES THROUGHOUT THE U.S. IN RECENT YEARS?**

A. One source of authorized ROEs for water utilities was prepared by AUS Utility Reports, which indicated the following averages:

Year	Average ROE <sup>4</sup>
2011	9.98%
2012	9.98%
2013	9.97%

<sup>4</sup> These reflect average authorized ROEs for the indicated time period. Some of the ROEs were set in prior years, so these do not necessarily reflect the ROEs established in the individual years.

2014	9.65%
2015	9.65%
2016 (Oct.) <sup>5</sup>	9.65%

I note that, even though this source is not available subsequent to late 2016, it is apparent that the average water/wastewater authorized ROEs have remained at or below the levels cited above.<sup>6</sup> Clearly, it is Mr. Walker whose ROE recommendations are outside the mainstream of those currently authorized throughout the U.S.

Finally, I note that Mr. Walker's reference to a single decision by this Commission is not a proper justification for setting PWR's ROE at 10.75 percent. To do so would cause the Company's ratepayers to pay rates based upon one of the highest authorize ROEs in the nation.

**IX. RESPONSE TO MR. DADAY'S REBUTTAL ON PWR COST OF DEBT**

**Q. WHAT IS THE NATURE OF MR. DADAY'S REBUTTAL TESTIMONY AS IT RELATES TO THE COMPANY'S COST OF DEBT?**

**A.** Mr. Daday's Rebuttal Testimony criticizes the Direct Testimonies of ORS witness Christina Seale and myself for employing the 5.04 percent cost of debt for PWR employed by Company witness Walker.

**Q. WHAT IS THE COST OF DEBT EMPLOYED BY THE COMPANY IN ITS DIRECT TESTIMONY?**

**A.** Company witness Walker states on page 17, lines 12-14 of his Direct Testimony, "I recommend using *PWR's embedded debt cost rate of 5.04%* for PWR as reflected and developed in Schedule 1." [emphasis added]

<sup>5</sup> Latest data available, as this report is no longer published.

<sup>6</sup> For example, S&P Global Market Intelligence publishes "RRA Water Advisory" that contains average authorized ROEs for water utilities. This is a proprietary publication.

**Q. DOES MR. WALKER’S USE OF THE PHRASE “PWR’S EMBEDDED DEBT COST RATE” SUGGEST THAT HE AND THE COMPANY AGREE THIS COST OF DEBT IS AN ACCURATE AND REASONABLE REFLECTION OF THE COMPANY’S ACTUAL COST OF DEBT?**

**A.** Yes, it does. Mr. Walker is PWR’s cost of capital witness in this proceeding and is recommending the total cost of capital, including the cost of debt, for the Company.

**Q. DID YOU AND THE ORS ALSO ADOPT THIS COST OF DEBT IN YOUR ANALYSES?**

**A.** Yes, we did.

**Q. WHAT IS COMPANY WITNESS DADAY’S RESPONSE TO THE ORS’S USE OF A 5.04 PERCENT COST OF DEBT?**

**A.** Mr. Daday states, on page 2, line 28 of his Rebuttal Testimony, that the 5.04 percent cost of debt used by the ORS is an “incorrect interest rate.” He goes on to say, “PWR does not agree with this proposed adjustment and *believes it to be factually incorrect*” (page 2, lines 29-30) [emphasis added]. On page 3, lines 14-16 of his Rebuttal Testimony, however, Company witness Daday states that the Company’s “cost of capital witness, Harold Walker, used the 5.04% to determine cost of capital *which is appropriate for that calculation*” [emphasis added].

**Q. CAN THE SAME COST OF DEBT BE BOTH “FACTUALLY INCORRECT” AND “APPROPRIATE” FOR CALCULATING A COMPANY’S COST OF CAPITAL?**

**A.** No, it cannot. There is no logic behind this argument. The embedded cost of debt reflects the interest expenses associated with the various debt obligations of the subject company. This element, in conjunction with the cost of equity, as well as debt and equity



ratios, is used to determine a company's weighted average cost of capital ("WACC") in rate of return analyses. There is only one cost of debt.

**Q. WHAT IS MR. WALKER'S RESPONSE TO MR. DADAY'S ALLEGATIONS REGARDING COST OF DEBT?**

**A.** On page 5, lines 20-22 of his Rebuttal Testimony, Company witness Walker states the following:

I would point out that PWR witness Daday takes issue in his rebuttal testimony with the *manner in which ORS addresses the effective interest rate* in its proposed accounting adjustments. [emphasis added]

**Q. GIVEN THAT THE 5.04 PERCENT COST OF DEBT WAS FIRST ADOPTED BY MR. WALKER, WOULD IT BE REASONABLE, THEN, TO INFER THAT MR. DADAY ALSO TAKES ISSUE WITH THE COST OF DEBT DEVELOPED AND EMPLOYED BY THE COMPANY'S ROE WITNESS?**

**A.** Yes, it would. In fact, Mr. Daday's attempts to discredit my and the ORS's use of the cost of debt employed by the Company's own ROE expert, while simultaneously supporting Mr. Walker's use of the same, is contradictory and illogical. There exists no reasonable justification in which Mr. Daday could defend the Company's own ROE expert's cost of debt and dismiss as inaccurate that same cost of debt measure adopted by an opposing party in this proceeding. To attempt to do so is erroneous and not in keeping with the fundamental principles of rate of return analyses.

**Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

**A.** Yes, it does.